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SUBJECT: SOUTH KOREA ECONOMIC BRIEFING - JUNE 2009

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Domestic Economy

ROKG to Invest 24.5 Trillion Won
in 17 New Growth Engines

12. (SBU) The Korean government announced in May plans to invest 24.5 trillion won (USD 19.5 billion) over the next five years in 17 industries that would serve as new growth engines for the country. They were classified into three main sectors: green technology (6.7 trillion won or USD 5.3 billion), cutting-edge convergence (12.2 trillion won or USD 9.6 billion) and higher value-added services (5.5 trillion won or USD 4.3 billion). As part of this plan, the government intends to train a core workforce of 700,000 during the next 10 years and will create 300 small and medium-sized enterprises (SMEs) by 2013.

Current Account Surplus of
USD 4.28 Billion in April

13. (SBU) The Bank of Korea (BOK) stated that the current account surplus was USD 4.28 billion in April, down from USD 6.65 billion in March. Korea has been running a current account surplus for three

consecutive months but the size of the surplus shrank in April as the Korean won strengthened against the dollar and domestic firms paid out greater dividend payments to overseas investors. The goods account posted a surplus of USD 6.17 billion in April, down from USD 6.98 billion in March as imports fell faster than exports. Customs-cleared exports fell 22.6 percent from a year ago and imports plunged 35.7 percent from a year ago as well. The services account deficit increased to USD 1.11 billion in April, up from a deficit of USD 650 million in March. The income account deficit, which tracks wages for foreign workers and dividend payments abroad, surged to USD 860 million in April from USD 220 million in March (domestic firms usually pay foreign shareholders dividends in this period).

Business Sentiment Recovering in May

14. (SBU) The BOK announced that the business survey index (BSI) of manufacturers was 74 in May, up five points from 69 in April. The BSI has increased for three consecutive months since bottoming out at 43 in February and is the highest since 75 in August 2008. Moreover, the Korea Chamber of Commerce and Industry forecasts the BSI for the third quarter to be 110, surpassing the benchmark index of 100 for the first time since the fourth quarter of 2007. An index higher than 100 indicates that there are more businesses optimistic than not about the economy in the upcoming quarter.

Manufacturing Production Continues Recovery in April

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15. (SBU) According to the National Statistical Office (NSO), industrial production in April fell 8.2 percent from the same month last year due to a decline in automobile, primary metal, and machinery device production but rose 2.6 percent from March, increasing for the fourth consecutive month. However, the month-on-month increase slowed from 7.1 percent in February. Meanwhile, the index of coincident macroeconomic indicators, which measures current business conditions, rose 1.5 percent and the index of leading macroeconomic indicators, which forecasts future business conditions, rose 1.6 percent in April from March.

ROKG Spends Over Half of 2009 Budget in First Five Months

16. (SBU) The Korean government spent 132.9 trillion won (USD 104.4 billion), or 51.6 percent of the 257.7 trillion won (USD 202.4 billion) budget for 2009 through the end of May. The government spent 13.2 trillion won (USD 10.4 billion) more than 119.7 trillion won (USD 94 billion) intended for the first five months of the year due to increased fiscal spending and expansionary policies to stimulate economic recovery. The government plans to spend 156.1 trillion won (USD 122.6 billion) in the first half of the year and only 101.6 trillion won (USD 79.8 billion) in the second half. This has led some experts to warn that the government's economic stimulus plan may soon run out of steam.

Corporate Sales Revenue Falls 0.6 Percent in Q1

17. (SBU) Based on a BOK survey of 1,534 companies, total sales revenue in the first quarter fell to 247 trillion won (USD 194 billion), 0.6 percent lower than the previous year and the first decline since the third quarter of 2003. Revenue for the manufacturing industry fell by 3.8 percent, the first decline since data collection began in 2003. However, revenue for the non-manufacturing industry rose 4.9 percent. The financial health of companies has sharply worsened. The aggregate debt-to-equity ratio rose 7.9 percentage points to 116.2 percent since the end of 2008 through the first quarter of 2009, reaching levels that haven't been seen since the first quarter of 2003.

Gross National Income Declines in Q1

¶18. (SBU) The BOK announced that real gross national income (GNI) for the first quarter shrank 0.2 percent from the previous quarter and 4.7 percent from a year ago, falling for the third consecutive quarter. Gross domestic product (GDP) for the first quarter rose 0.05 percent from the previous quarter due to increased government spending and interest rate reductions. However, GDP fell 4.2 percent from a year ago, the largest year-on-year change since the 6 percent contraction in the fourth quarter of 1998. Due to the global economic downturn, GDP declined 3.4 percent from the previous year in the fourth quarter of 2008.

Foreign Currency Reserves Reach USD 226.8 Billion

¶19. (SBU) The BOK announced that Korea's foreign currency reserves reached USD 226.8 billion at the end of May, up USD 14.3 billion from USD 212.5 billion at the end of April. This was the steepest monthly rise since 1998. This increase was mainly due to an increase in operating profits of the foreign reserves, redemptions at maturity of the foreign currency liquidity supplied by the BOK and the Foreign Exchange Stabilization Fund, and increases in the value of non-dollar assets when converted into US currency terms. The reserve has swelled by a total of USD 25.2 billion from the end of February through the end of May after significant declines in the second half of 2008.

Finance and Structural Policies

MOSF Cautious on Outlook Based on Mixed Indicators

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¶10. (SBU) According to the Ministry of Strategy and Finance (MOSF), domestic credit card purchases rose 8.7 percent year-on-year in May, indicating improved consumer confidence. Sales revenue for department stores and large discount stores rose 5.4 percent and 1.7 percent, respectively. However, the MOSF remained cautious in light of sluggish economic indicators such as domestic demand, exports, employment, and investment in new facilities. In the first quarter of 2009, facility investment fell 22.1 percent from a year earlier and 9.6 percent from the previous quarter.

BIS Capital Ratio of Domestic Banks Rises in March

¶11. (SBU) The Bank for International Settlements (BIS) capital ratio of domestic banks under the Basel II framework went up to an average of 12.94 percent as of March 31, 2009 from 12.31 percent at the end of last year. The Tier 1 capital (book value of a bank's stock plus retained savings) ratio of banks also rose from 8.84 percent to 9.51 percent over the same period. The rise was attributed to the banks' capital expansion and decreased risk-weighted assets. During the first quarter of 2009, the capital of domestic banks increased by 6.9 trillion won (USD 5.4 billion) or 4.7 percent through issuances of stocks and hybrid capital instruments totaling 7.5 trillion won (USD 5.9 billion). This figure includes the purchase of 3.95 trillion won (USD 3.1 billion) by the Bank Recapitalization Fund and gains from net income.

33 Companies to Be Restructured

¶12. (SBU) The Financial Services Commission (FSC) announced that Korea's 18 creditor banks have chosen 33 companies for corporate restructuring after conducting a regular credit risk assessment of 433 companies, each with more than 50 billion won (USD 39.3 million) in debt to financial institutions. Out of these 33 companies, 22 companies rated as C grade will be subjected to refinancing and debt rescheduling programs led by creditor banks. The 11 companies that rated as D-grade will be cut off from fresh loans and will have to find ways to stay afloat on their own. The creditors have conducted

credit risk assessments since April in efforts to weed out weak manufacturers and will continue their reviews of small and medium-sized enterprises (SMEs) this month.

BOK Keeps the Benchmark Interest Rates at 2 Percent

¶13. (SBU) The BOK Monetary Policy Committee decided to keep the benchmark interest rate at 2 percent in June, freezing the rate for the fourth consecutive month. The BOK and the South Korean government did not see the need to raise interest rates which could hinder economic recovery efforts. At a press conference immediately following the meeting, BOK Governor Lee Seong-Tae said, "owing to an aggressive economic stimulus package, production activities improved significantly and the domestic demand slump eased, indicating that the economy has nearly bottomed out." However, he later noted that huge uncertainties still remain.

Domestic Insurers Post Net Profit in FY2008

¶14. (SBU) The Financial Supervisory Service (FSS) said 22 life insurance companies posted a total net profit of 617.2 billion won (USD 485.2 million) in the fiscal year 2008 (April 2008 to March 2009), down 70.7 percent from the previous year. During the same period, 29 liability insurance companies earned 1.31 trillion won (USD 1 billion) in net profit, down 21.8 percent from the previous year. The solvency ratio (net assets to liability reserve or appropriate surplus), which indicates the financial health of insurance companies, was 216.3 percent for life insurance companies, falling 20.8 percentage points from a year ago, and 275.5 percent for non-life insurance companies, dropping 13.2 percentage points.

STEPHENS